

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
GLORIA VANDERBILT-COOPER	:	DETERMINATION
for Redetermination of a Deficiency or for	:	
Refund of New York State Unincorporated Business	:	
Tax under Article 23 of the Tax Law for the	:	
Years 1978, 1979 and 1980.	:	

Petitioner, Gloria Vanderbilt-Cooper, c/o Richard W. Miske, 200 East 42nd Street, New York, New York 10017, filed a petition for redetermination of a deficiency or for refund of New York State unincorporated business tax under Article 23 of the Tax Law for the years 1978, 1979 and 1980 (File No. 801272).

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on December 9, 1987 at 1:15 P.M. Petitioner appeared by Ferro, Berdan & Co., C.P.A.'s (Richard W. Miske, C.P.A.). The Audit Division appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly determined that income reported by petitioner as business income (per Schedule C, Form 1040) for each of the years in question was properly subject to unincorporated business tax.

II. Whether the gain realized by petitioner upon her sale of a registered trademark in 1980 was properly held subject to unincorporated business tax by the Audit Division.

III. Whether penalty imposed against petitioner pursuant to Tax Law §§ 722 and 685(a)(1) should be abated in light of the facts and circumstances brought forth in this case.

FINDINGS OF FACT

1. Petitioner, Gloria Vanderbilt-Cooper, filed a New York State Income Tax Resident Return for each of the years 1978, 1979 and 1980. For each of said years petitioner listed her occupation as "artist/writer/designer". Included with her filings for the years 1979 and 1980 was a New York State Unincorporated Business Tax Return (Form IT-202). No Unincorporated Business Tax Return was filed by petitioner for the year 1978.

2. On each of the above-noted personal income tax returns, petitioner reported certain income as "business income", in the dollar amounts specified hereinafter (see ___ Finding of Fact "5", *infra*). The same amounts were also reported by petitioner on the two unincorporated business tax returns as "net profit (or loss) from business" (at line "1"), but were treated thereafter

as income not subject to the unincorporated business tax and zero liability was shown on each of said returns. Further, the same amounts of business income were reported for 1979 and 1980 on Forms IT-250 (Maximum Tax on Personal Service Income) as personal service income subject to the benefits afforded pursuant to the maximum tax calculation provisions (Tax Law former § 603-A).

3. In addition to the foregoing items reported as business income, petitioner's return for 1980 also reflected a (capital) gain in the total amount (for said year) of \$2,171,789.00, derived from the sale of a registered trademark as described hereinafter.

4. On April 13, 1984 the Audit Division issued to petitioner a Notice of Deficiency asserting additional unincorporated business tax due for the years 1978, 1979 and 1980 in the aggregate amount of \$209,405.12, plus penalty and interest.

5. A Statement of Audit Changes previously issued to petitioner on August 16, 1983 provided an explanation and calculation of the aforementioned deficiency, including specifically an indication that penalty was being imposed pursuant to Tax Law § 685(a)(1) based upon failure to file timely returns for the years 1978 and 1979, as follows:

"The income from your activities as artist, writer and designer is subject to the unincorporated business tax.

Capital gains for unincorporated business tax purposes are taxable at 100%.

Penalty for late filing has been applied at 5% per month at a maximum of 25% (Section 685(a)(1) of the New York State Tax Law).

	<u>1978</u>	<u>1979</u>	<u>1980</u>	
Income from business	\$344,722.00	\$1,073,396.00	\$1,458,616.00	
Capital gains			<u>2,171,789.00</u>	
Total business income	\$344,722.00	\$1,073,396.00	\$3,630,405.00	
Allowance for taxpayer's services	(5,000.00)	(5,000.00)	(5,000.00)	
Business exemption	<u>(5,000.00)</u>	<u>(5,000.00)</u>	<u>(5,000.00)</u>	
Taxable business income	\$334,722.00	\$1,063,396.00	\$3,620,405.00	
Unincorporated Business Tax on above	16,736.10	47,852.82	144,816.20	\$209,405.12
Section 685(a)(1)	4,184.03	11,963.21		<u>16,147.24</u>
TOTAL TAX AND PENALTY DUE:				<u>\$225,552.36"</u>

6. As the facts herein bear out, petitioner's name is undeniably well known and recognized. Some years prior to those at issue herein, petitioner studied art at the Art Student's League in New York City, as well as under the tutelage of many well-known artists and, over a period of time, became well known for her own artwork. More specifically, petitioner presented

over the course of her career many critically acclaimed one-woman shows of oil paintings, watercolors, and pastels.

7. Commencing in or about the years 1968 through 1970, and continuing thereafter, certain companies determined that petitioner's artwork might be particularly adaptable to their product lines. For example, Hallmark, a manufacturer of paper products, and Bloomcraft, a textile manufacturer, among others, determined petitioner's artwork to be particularly adaptable to their products. Accordingly, petitioner, under license, allowed certain of her original and existing paintings to be reproduced on various companies' products. In addition, petitioner created certain other paintings and artistic designs specifically for various companies for use on their products. The types of products to which petitioner's artistic designs and paintings were adapted were linens, china, glassware, and flatware. With respect to the latter three items, petitioner would paint on the blank glass, china or flatware, and the company would thereafter reproduce petitioner's painting or design in bulk on these products for sale. As a result of these endeavors petitioner's work, as well as her name, became increasingly well-known.

8. During the decade of the 1970's, petitioner allowed her name to be licensed and carried on a line of fashion eyeglasses, a line of perfume, and a line of clothing bearing her name. Included in the line of clothing was a line of blouses designed and produced by a company known as Murjani Corporation ("Murjani"), bearing petitioner's name in replacement of the previously carried name "Lucky Pierre". At hearing, petitioner claimed to have had no input as to the actual design of the clothing, eyewear or perfume, explaining that she "claimed no gift for such endeavors". Rather, petitioner indicated that she merely consented to and licensed the use of her name on such products. Certain of the aforementioned product lines were commercially successful, whereas others failed.

9. In or about 1979 Murjani, through one of its principals, suggested (noting the fact that it then had the largest quota of denim material in the United States) the creation of a line of designer jeans which would carry petitioner's signature. Petitioner agreed that this could be a successful endeavor, and brought in a pair of her own jeans as a model for the cut and fit of the jeans to be designed. The jeans were produced, bore petitioner's signature and the line commonly known as "Gloria Vanderbilt" designer jeans became financially very successful. In turn, petitioner notes that the success of this line of designer jeans further increased the recognizability and commercial value of her name.

10. With respect to the various enterprises previously described, petitioner received compensation in the form of royalties paid pursuant to the terms of various licensing agreements between petitioner and the various manufacturers producing and selling the items bearing petitioner's name. The largest single source of such income during the latter two years in question was generated from Murjani (see infra), specifically from the sale of Gloria Vanderbilt designer jeans. Petitioner's compensation from this endeavor was governed by a licensing agreement entered into on August 1, 1978 between petitioner and Murjani.¹ Under this agreement petitioner gave to Murjani, subject to certain pre-existing licensing agreements with other manufacturers, the right to use petitioner's name on certain Murjani products. Petitioner's name was denominated in said agreement as "the Mark" (as a trademark). In exchange for the use of her name pursuant to this licensing agreement, petitioner was to be compensated by Murjani in the minimum amount of \$225,000.00 per year, payable in equal monthly installments,

¹No licensing agreements between petitioner and manufacturers other than Murjani were introduced in evidence.

plus an additional amount based upon a (varying) percentage of the net amounts of sales of products bearing petitioner's name.

11. The agreement between petitioner and Murjani provided that petitioner reserved the right to the use of her name without restriction for her personal affairs, and for publishing, writing, painting, theater, television and radio appearances, recordings, etc. The agreement contained a provision such that it was to survive petitioner's death. Pursuant to the agreement, petitioner consented to submit to medical examinations as required by Murjani for the purpose of securing insurance policies on the life of petitioner. However, this particular provision of the contract was never exercised by Murjani. In addition, petitioner agreed to apply for and maintain trademarks in such countries where, in Murjani's judgment, it was commercially feasible for Murjani to market its products bearing petitioner's name. Petitioner also agreed to use her best efforts to promote the Murjani products carrying her name by personal appearances, advertisements, etc., within reasonable bounds in light of petitioner's personal health, as requested by Murjani. Murjani agreed to pay petitioner's reasonable first class travel and living expenses (as well as the travel and living expenses of one employee of petitioner) as such were connected with the promotional appearances. These promotional appearances were not to exceed 90 days in any one year of the agreement.

12. Also included in the licensing agreement was a provision whereby Murjani could purchase the Mark for \$8,000,000.00 in cash. It was Murjani's installment purchase of the Mark, in the year 1980, which generated the capital gain income included as subject to unincorporated business tax by the Audit Division.

13. With respect to the personal appearances and promotions called for in the agreement, petitioner acknowledged that she did make personal appearances at various stores throughout the country. She characterized these appearances as in the nature of promotional appearances benefiting all of her licensed product lines including (but not limited to) those products manufactured by Murjani and bearing petitioner's name. Murjani did reimburse petitioner for the expenses of travel and lodging in connection with such appearances. Petitioner testified that she could not recall a specific number of appearances in any one of the years in question, but acknowledged that she made many such promotional appearances. Petitioner testified that, in her mind, the benefit of such appearances inured not only to the Murjani line of items but also to whatever other items bearing petitioner's name were being sold in a given store where she appeared, including home furnishing items and artistic productions such as lithographs.

14. Included with petitioner's income tax returns for each of the years 1978, 1979 and 1980 were Schedules C (Profit [or Loss] from Business or Profession) on which petitioner listed the income at issue as business income, and also enumerated the expenses incurred in connection therewith.² The individual sources of income and expenses for 1978 and 1979 were reported as follows:

²Documents in evidence include a statement that the expenses could not be allocated to particular activities or sources of income.

<u>Source of Income</u>	<u>1978</u>	<u>Amount</u>
Talent & Residuals Inc.		\$ 5,000
Rollins & Joffe Productions-W.A.S.P.		61
Zyloware		17,761
James Seaman Studios		90,945
Westpoint Pepperell		61,853
Doubleday		7,895
Bloomcraft Inc.		7,652
Glentex		3,782
McCall Magazine		66
Conde Nast-Women to Women		375
Murjani USA		<u>93,750</u>
Total Income		<u>\$449,140</u>

Petitioner reduced such total income of \$449,140.00 by expenditures totalling \$104,418.00 (listed below) to arrive at net (business) income of \$344,722.00.

<u>Expenditures</u>	<u>1978</u>	<u>Amount</u>
Agents Commissions & Expenses		\$ 13,995
Staff Salaries		24,729
Payroll Taxes		2,004
Studio Rent		5,326
Car Rentals		2,399
Staff Supplies and Expenses		8,086
Photos		675
Telephone		4,198
Electricity		807
Accountant		8,600
Legal		2,000
Hairdresser Make Up and Facial Treatments for Personal & TV Appearances & Interviews		3,354
Entertainment		6,309
Trade Papers and Periodicals		304
Theater Tickets		724
Books for Research		874
Office Security Protection		2,995
Wardrobe and Accessories for Store Promotional Appearances and Interviews		13,063
Flowers		420
Local Transportation		890
Office Maintenance & Decorating (8549 x 20%)		1,710
Luggage Repairs		119
Art Supplies and Expenses		387
Moving Expense		<u>450</u>
Total Expenses		<u>\$104,418</u>

<u>Source of Income</u>	<u>1979</u>	<u>Amount</u>
Murjani International Ltd.		\$1,092,721
Murjani International Ltd.		71,330
Zyloware Corporation		140,717
James Seaman Studios Inc.		104,256
Westpoint Pepperell Inc.		4,207
National Paragon Corporation		3,000
Bloomcraft Inc.		2,225
Kimberly Clark		7,500
Gloria Vanderbilt Ltd.		166,717
Gloria Vanderbilt Ltd.-Expense Reimbursement		5,784
Pearl Bedell Lithographs		278
McCall Patterns		13
Total Income		<u>\$1,598,748</u>

Petitioner reduced such total income of \$1,598,748.00 by expenditures totalling \$525,352.00 (listed below) to arrive at net (business) income of \$1,073,396.00.

<u>Expenditures</u>	<u>1979</u>	<u>Amount</u>
Agents Commissions		\$273,875
Business Management & Professional Fees		112,091
Staff Salaries		29,072
Payroll Taxes		3,079
Studio Rent		7,549
Staff Supplies, Expenses and Design Samples		10,046
Telephone		5,068
Utilities		1,465
Repairs & Maintenance		2,306
Travel & Entertainment		26,451
Office Security Protection		1,377
Auto Rental		2,722
Hairdressing, Make-Up and Facial Treatments for Personal & TV Appearances & Interviews		5,598
Subscriptions, Periodicals & Newspapers		2,614
Photos		819
Art Supplies and Expenses		2,958
Wardrobe and Accessories for Store Promotions Appearances and Interviews		30,383
Free Lance Artist		4,960
Local Transportation		1,380
Bank Charges		50
Insurance		711
Cleaning & Maintenance of Wardrobe		778
Total Expenses		<u>\$525,352</u>

15. For 1980, petitioner's return did not include a listing of the individual sources from which the reported total business income was generated. Rather petitioner's Schedule C for 1980 reflected gross receipts of \$2,245,900.00, expenditures of \$787,284.00 (listed below) and net (business) income of \$1,458,616.00.

<u>Expenditures</u>	<u>1980</u>	<u>Amount</u>
Agents Commissions		\$239,977
Financial and Managerial Advising		195,556
Staff Salaries		36,401
Payroll Taxes		3,779
Studio Rent		4,400
Staff Supplies and Expenses		21,623
Professional Fees		78,706
Depreciation		6,550
Dues and publications		934
Interest		4,699
Repairs		3,702
Taxes		42,977
Telephone		868
Travel and entertainment		18,922
Utilities		6,601
Security Protection		1,951
Auto and Limousine Rental		4,725
Promotional Photos		506
Art Supplies and Expenses		2,445
Store Promotions and Interviews		97,012
Freelance Artists		6,140
Bank Charges		22
Cleaning and Maintenance		1,834
Hairdressing and Make-up for Appearances		<u>6,954</u>
Total Expenses		<u>\$787,284</u>

SUMMARY OF THE PARTIES' POSITIONS

16. The Audit Division asserts, based upon the terms of the Murjani licensing agreement, as described, and upon the manner in which petitioner's returns were filed, that petitioner was not receiving income solely as a result of allowing the licensing of her name, but rather was actively engaged in the ongoing business of promoting and selling her name. The Audit Division argues that the nature of petitioner's activities takes the receipts in question out of the category of merely passive receipts earned as royalties and renders the same as business income subject to the unincorporated business tax during the years in question. The Audit Division maintains that the licensing agreement provision by which Murjani could require petitioner to submit to physical examination for life insurance purposes was present to protect Murjani from loss in the case of petitioner's death and consequent inability to make personal promotional appearances. In this vein, the Audit Division thus asserts that the contract provisions calling for the performance of personal promotional appearances clearly renders the income received by petitioner as income derived from the performance of personal services thus subject to the unincorporated business

tax.

17. Petitioner asserts, by contrast, that the income in question is royalty income generated solely upon the recognizability and marketability of her name. Petitioner argues that her personal services, in the nature of promotional appearances, were not a material factor in the success of the sale of products or in the generation of income. Petitioner asserts the income in question was in the nature of passive income, specifically royalty income generated from the licensing of petitioner's name for attachment to certain products as described. In addition to asserting that the personal appearances were incidental in nature with respect to the success of petitioner's licensing and generation of royalty income, petitioner maintains (contrary to the Audit Division's position) that Murjani's choice not to purchase life insurance on petitioner's life supports a conclusion that petitioner's personal appearances did not have a material impact on the success of the licensed products and that Murjani would certainly have insured petitioner's life if, in its estimation, her death would have resulted in a material loss to Murjani in terms of product marketability and sales success. Petitioner argues likewise that survival of the agreement notwithstanding petitioner's death militates against a conclusion that the personal appearances by petitioner were of any particular importance.

18. In addition to the issue of taxability, petitioner seeks abatement of the penalty asserted herein. Petitioner maintains that the position she takes as to the taxability issue is, in light of the facts, a reasonably held position. Petitioner also asserts, in this regard, reliance upon the decision in Matter of Merrick v. Tully (68 AD2d 289).

19. Finally, the parties do not dispute the correctness of the dollar amounts shown as at issue herein, but rather disagree only as to whether such amounts of income represent income subject to the unincorporated business tax.³

CONCLUSIONS OF LAW

A. That during the years at issue herein, Tax Law former § 701(a) imposed a tax upon the unincorporated business taxable income of every unincorporated business wholly or partly

³It should be noted that petitioner had initially (prior to hearing) taken the position that the income in question was entirely exempt from unincorporated business tax pursuant to Tax Law § 703(c) (the so-called "professions" exemption). However, petitioner has abandoned this position, maintaining now that the income is purely passive royalty income exempt because petitioner was not engaged in an unincorporated business. In this regard, no evidence was presented to show what portion, if any, of the subject income represents income earned solely from petitioner's work as an artist, as opposed to income earned from the various licensing agreements as described.

carried on within New York State.⁴

B. That Tax Law former § 703(a) defined an unincorporated business as follows:

"General. - An unincorporated business means any trade, business or occupation conducted, engaged in or being liquidated by an individual or unincorporated entity, including a partnership or fiduciary or a corporation in liquidation...."

C. That Tax Law former § 705(a) defined unincorporated business gross income to mean:

"the sum of the items of income and gain of the business, of whatever kind and in whatever form paid, includible in gross income for the taxable year for federal income tax purposes, including income and gain from any property employed in the business, or from liquidation of the business, or from collection of installment obligations of the business, with the modifications specified in this section."

D. That in the instant matter, the determination of taxability revolves around whether petitioner's activities were of such a continuous, regular and ongoing nature that they constituted the carrying on of an unincorporated business or, to the contrary, whether petitioner merely allowed her name to appear on various products in exchange for a percentage of the income earned from the sales of said products (see generally 20 NYCRR 203.1[a], [b]).

E. That based upon the evidence presented petitioner's activities, taken as a whole, constituted the conduct of an unincorporated business the income from which was properly subject to unincorporated business tax. One factor considered in the conclusion that the income in question was subject to the unincorporated business tax is the manner in which petitioner reported the income. In this context, petitioner reported the income as business income for each year on Schedule C, and as personal service income on Form IT-250 (see Finding of Fact "2"). In addition petitioner claimed certain not insubstantial expenses and reported the same expenses as being incurred in relation to the generation of the income in question (see Findings of Fact "14" and "15").

Another significant factor is the number of personal appearances made by petitioner for promotional purposes. In this regard, the language of the Murjani agreement required personal appearances each year and, in fact, petitioner acknowledged having made many such personal appearances admittedly for promotional purposes. Notwithstanding that her name was (and is) undeniably well-recognized and, in turn, a valuable asset, it appears that the nature of petitioner's activities constituted significant, ongoing promotional activities with respect thereto as opposed to merely passive allowance of the use of her name on products in exchange for income from licensing agreements therefor. In sum, although the number of personal appearances was not specified, such appearances were clearly more than incidental in nature. It is noteworthy that the number of appearances petitioner could be required to make for Murjani in any one year was set at 90 appearances, a not insignificant number, constrained only by petitioner's right to limitation based on the status of her health. Petitioner also admitted by her own testimony a belief that her promotional appearances and activities benefited not only Murjani products but all of the

⁴The unincorporated business tax, imposed pursuant to Tax Law Article 23, was repealed effective December 31, 1982.

products with which her name was associated. The factors that the agreement survived petitioner's death and that Murjani possessed the right to insure petitioner's life but did not do so, do not provide sufficient support to adopt petitioner's assertions of nontaxability.

Accordingly, in view of all of the evidence, it is concluded that petitioner's activities in promoting her name and the products with which her name was associated pursuant to multiple licensing agreements were of such a continuous, ongoing and regular nature as to constitute the carrying on of an unincorporated business the income from which was properly subject to unincorporated business tax. In like manner, the gain realized by petitioner upon her sale of the Mark in 1980 constituted income from the sale of an asset used in her unincorporated business properly subject to unincorporated business tax.

F. That petitioner asserts reliance upon *Matter of Merrick v. Tully* (68 AD2d 289), wherein royalty income received by David Merrick from a record company which used his name on the jacket of a record and from purchasing the contract rights of a composer and lyricist of a play was held not to constitute receipts subject to the unincorporated business tax. However, the matter at hand differs from *Merrick* in that the royalty income derived from the inclusion of petitioner Merrick's name on the record jacket was found specifically to have had no connection with petitioner Merrick's activities in the theater (such theater activities were held to be activities constituting the conduct of an unincorporated business by petitioner Merrick), and the royalties earned from the contract involved the production of a play in which petitioner Merrick was not involved. In essence, the Court held these two sources of royalty income to represent solely passive investment activities by petitioner Merrick for his own account, in connection with which no actions were required or undertaken by petitioner Merrick. Here, by contrast, not only was petitioner required to carry on promotional activities, but petitioner in fact did make numerous personal promotional appearances. Unlike the situation in *Merrick*, petitioner's income did not result merely from passive investment activities.

G. That petitioner has established reasonable cause warranting abatement of the penalty imposed pursuant to Tax Law §§ 722 and 685(a)(1). The evidence bears out that the issue presented is one involving a factual situation wherein reasonable minds could legitimately differ as to whether the activities in question rose to the level of constituting an unincorporated business properly subject to the unincorporated business tax. In addition, although, as noted, *Matter of Merrick v. Tully* (*supra*) is distinguishable, petitioner's reliance upon the result reached therein with respect to the issue of royalty income constitutes a reasonable basis for petitioner's position and supports the conclusion that the penalty should be abated.

H. That the petition of Gloria Vanderbilt-Cooper is hereby granted to the extent indicated in Conclusion of Law "G" but is in all other respects denied, and the Notice of Deficiency dated April 13, 1984, as modified to reflect elimination of the penalty asserted, is sustained.

DATED: Albany, New York
May 12, 1988

/s/

ADMINISTRATIVE LAW JUDGE